Supreme Court, U.S.
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No. 96-454

In The

Supreme Court of the United States

October Term, 1996

IN RE: ELRAY RASH AND WIFE JEAN RASH,

Debtors,

ASSOCIATES COMMERCIAL CORPORATION,

Appellant,

v.

ELRAY RASH AND WIFE JEAN RASH,

Appellees.

On Writ Of Certiorari
To The United States Court Of Appeals
For The Fifth Circuit

AMICUS CURIAE BRIEF OF THE NATIONAL ASSOCIATION OF CHAPTER 13 TRUSTEES IN SUPPORT OF DEBTORS/APPELLEES

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CONSENT STATEMENT

All parties have consented that the National Association of Chapter Thirteen Trustees (NACTT) may file this brief. *Amicus* National Association of Consumer Bankruptcy Attorneys, Inc., files the parties' written consent stating that the NACTT may do so.

INTERESTS OF *AMICUS CURIAE*

The NACTT is a non profit organization, established in 1968, for the purpose of providing educational and training assistance to Chapter 13 trustees and practitioners involved in the consumer bankruptcy process and in Chapter 13 in particular. The NACTT membership includes approximately 95% of the standing Chapter 13 trustees appointed in the United States. In the 12-month period ending June 30, 1996, 305,527 non business Chapter 13 cases were filed in the United States. These cases involve numerous valuation issues, all of which statutorily involve the trustees.

A bankruptcy trustee acts as a fiduciary of all creditors of an estate, charged with the duty to treat all creditors fairly. *In re Cochise College Park, Inc.,* 703 F.2d 1339 (9th Cir. 1983). In so doing, the trustee's duties include maximizing the distribution of funds to all creditors, not simply one creditor over the other. *See In re Consupak,* 87 B.R. 529 (Bankr. N.D. Ill. 1988). The application of the long standing "bankruptcy rule" in valuation of collateral, which establishes the extent of a secured claim in an individual reorganization, has the effect of maximizing a fair return to all creditors, including the general

unsecured creditors. Abandonment of the "bankruptcy rule" through a strained interpretation of 11 U.S.C. § 506, would have the effect of artificially inflating the distribution of available funds in a consumer reorganization to one type of creditor, to the detriment and at the expense of the general unsecured claimholder.

It is entirely appropriate for the NACTT to present this argument to this court, advocating for the clear interpretation of 11 U.S.C. § 506 which preserves the "bankruptcy rule." Trustees under Chapter 13 do not hold any economic interest in the outcome but are statutorily obligated to "appear and be heard at any hearing that concerns . . . the value of property subject to a lien." 11 U.S.C. § 1302(b)(2)(A). The appropriate interpretation of 11 U.S.C. § 506 in Chapter 13 cases has a significant and real impact on the statutory duties of trustees in those cases.

SUMMARY OF THE ARGUMENT

"The bankruptcy rule" provides that to receive dividends from estate proceeds, a secured creditor must first 1) forfeit to the estate his security; or 2) repossess the security, sell it, apply the proceeds to the debt, and prove for the remainder. Thus, in those instances when a security must be valued, the bankruptcy rule views the security from the perspective of how much a creditor would receive for it at resale. At no time has the bankruptcy rule allowed for valuing security based on its replacement cost to the debtor.

In 1800, Congress began enacting bankruptcy statutes. Prior to the 1978 enactment of 11 U.S.C. § 506(a), every pertinent bankruptcy statute provided for valuing secured collateral in a manner consistent with the bankruptcy rule. No statute allowed for valuing security based on its replacement cost to the debtor.

No evidence exists that Congress intended section 506(a) to depart from established practice under the bankruptcy rule. Indeed, the statute's plain language, its legislative history, and events occurring after its enactment, all point to a contrary conclusion.

Valuing the secured portion of Rash's debt to Associates based on proceeds Associates would receive through repossession and resale of Rash's truck is consistent with the bankruptcy rule. Because Congress nowhere indicated that section 506(a) was a departure from practice under this venerable rule, this Court should reject Associate's attempt to achieve a result inconsistent with it.

ARGUMENT

This Court presumes that Congress legislates with knowledge of existing law pertinent to the topic involved. *Cannon v. University of Chicago*, 441 U.S. 677, 696-97, 99 S.Ct. 1946, 60 L.Ed.2d 560 (1979). In the absence of evidence that Congress enacted a statute aimed at achieving a result inconsistent with existing law, this Court interprets statutes consistent with that law. *Goodyear Atomic Corp. v. Miller*, 486 U.S. 174, 184-85, 108 S.Ct. 1704, 100 L.Ed.2d 158 (1988). Because the bankruptcy rule's hoary tradition was well-established at the time

Congress enacted section 506(a), and because no evidence exists that Congress intended that provision to achieve a result inconsistent with that rule, this Court should interpret section 506(a) consistent with the bankruptcy rule. *See Miles v. Apex Marine Corp.*, 498 U.S. 19, 32, 111 S.Ct. 317, 112 L.Ed.2d 275 (1990).

A. The Bankruptcy Rule Existed For 178 Years Prior To The Enactment Of Section 506(a)

In 1800, Congress enacted its first bankruptcy statute. That statute provided that

> In the distribution of the bankrupt's effects, there shall be paid to every of the creditors a portion-rate, according to the amount of their respective debts, so that every creditor having security for his debt by judgment, statute, recognizance or specialty, or having an attachment . . . on the estate of such bankrupt . . . shall not be relieved . . . for more than a ratable part of his debt with the other creditors of the bankrupt.

Act of April 4, 1980, c. 19, § 31, 2 Stat. 30. Given that this language parroted earlier English bankruptcy acts, this Court interpreted it consistent with the construction English judges gave those acts. *See, e.g., Tucker v. Oxley*, 5 Cranch 34, 42 (1809).

Under English bankruptcy statutes existing prior to the Revolution, judges applied "the bankruptcy rule". That rule provides that to receive dividends from estate proceeds, a secured creditor must first 1) forfeit to the estate his security; or 2) repossess the security, sell it,

apply the proceeds to the debt, and prove for the remainder. Thus, in those instances when a value was placed on collateral, the bankruptcy rule commands that the secured creditor *"must have his security sold"* and subtract from the total debt proceeds received from that sale. *Merrill v. National Bank of Jacksonville*, 173 U.S. 131, 153, 10 S.Ct. 360 (1899) (White, J., dissenting) (italics added, citing cases). As one English Chancellor explains, as of 1800 it had been

> long established in bankruptcy not to suffer a creditor holding a security to prove unless he will give up that security, or the value has been ascertained *by the sale of it*. The reason is obvious. Till the debt has been reduced *by the proceeds of that sale*, it is impossible correctly to say what the actual amount is.

Ex parte Smith, 2 Rose 63 (1813) (italics added); *see also Merrill*, 173 U.S. at 173 (Gray, J., dissenting) ("long before the American Revolution, (it had) become the settled practice in the court of chancery, that a (secured creditor) *must have his collateral security sold*, and prove for the rest of the debt only").

Justice Storey drafted the successor to the 1800 act, the Bankrupt Act of 1841. By this time, the bankruptcy rule was so well established that Justice Storey determined that no specific reference to it was required. *See Merrill*, 173 U.S. at 175 (Gray, J., dissenting). In *Ex parte The Bank of New Orleans*, 3 Howard 292, 11 L.Ed. 603 (1845), this Court confirmed that while the 1841 act was silent as to the bankruptcy rule, that rule continued to control the extent to which a secured creditor could prove a claim against a bankrupt's estate. "If [creditors] have a

pledge or mortgage (on a bankrupt's claim), they may apply to the court *to have the same sold,* and the proceeds thereof applied towards the payment of their debts pro tanto, and to prove for the residue." *Id.*, 3 Howard at 315.

In 1867, Congress inserted an express provision codifying the bankruptcy rule. This enactment

> was but the incorporation into the statutes of the rule which had arisen as a consequence of the requirement for a ratable distribution, which had existed for hundreds of years before. . . .

Merrill, 173 U.S. at 161 (White, J., dissenting).

In 1898, Congress enacted the Bankruptcy Act. That act required a secured creditor to deduct the value of his security from his claim before receiving an estate dividend on the remainder of that claim. Consistent with the bankruptcy rule, the value of the security was determined

> by converting the same into money according to the terms of the agreement pursuant to which such securities were delivered to such creditors, or by such creditors and the trustee by agreement, arbitration, compromise or litigation, as the court may direct.

11 U.S.C. § 93(h). Thus, the 1898 Bankruptcy Act preserved as a method of valuation the bankruptcy rule's command that the security be sold. While that act added additional valuation methods, none of those methods involved the collateral's replacement cost to the debtor.

In 1938, Congress enacted the Chandler Act. That act provided that under certain circumstances, debtors could retain and employ items which secured their debts rather

than being required to relinquish those assets to the secured creditor. As Representative Michener explained, under the Chandler Act

> the theory now is to conserve rather than liquidate the estate, give the debtor a chance to work out his financial difficulties and not destroy his business. . . . Possibly he may remain in possession of his property until his creditors are brought to a realization of the fact that perhaps there is more in it financially for them and that it is better for the bankrupt and for the country if the bankrupt is permitted to continue in his business and the creditors compromise their claims.

Cong.Rec.H. 8649 (August 10, 1937).

In a reorganization bankruptcy under the Chandler Act, secured creditors could not file claims or receive estate distributions based on the secured portion of a claim. They could, however, file a claim for the unsecured portion of the debt. Because a bankruptcy reorganization envisioned the debtor retaining the security, the traditional method of valuing the security under the bankruptcy rule, selling it, was unavailable. Thus, courts turned to a logical substitute: estimating proceeds that would result had the secured creditor repossessed the collateral and disposed of it in a commercially reasonable manner. *See, e.g., In re Pennyrich International, Inc. of Dallas,* 473 F.2d 417, 424 (5th Cir. 1973); *In re American Kitchen Food, Inc.,* 2 BCD 715, 722 (N.D. Me. 1976); *In re Garcia,* 396 F.Supp. 518, 521 (C.D. Cal. 1974).

B. Prior To Enacting 11 U.S.C. § 506, Congress Nowhere Indicated It Intended That Statute To Depart From Practice Under The Bankruptcy Rule

The language of section 506 does not in any way indicate that it breaks 178 years of Congressional homage to the bankruptcy rule. Indeed, by providing for valuation of a secured claim based on "*the creditor's* interest in the estate's interest", section 506 conclusively reveals that Congress intended no such break. Consistent with the statute's language, section 506's legislative history nowhere indicates that Congress intended it to deviate from the bankruptcy rule.

Under the Chandler Act, creditors holding security interests in essential debtor property, through threat of repossession, were able to coerce bankruptcy debtors to reaffirm their secured debt. Thus, "the question [was] raised as to how much relief the debtor actually gets." *Report of the Commission on the Bankruptcy Laws of the United States*, H.R. Doc. No. 93-137, 93rd Cong., 1st Sess., (hereafter "Commission Report"), Part I at 3-4. In 1970, Congress created the Commission on Bankruptcy Laws to study this and other problems.

In 1973, the Commission submitted its report to Congress and proposed a new bankruptcy code. In recognizing the trouble created by forced reaffirmation of secured debts, the Commission demonstrated that sale upon repossession continued to provide the baseline from which secured collateral should be valued.

> [A] debtor may face a choice between entering an agreement to reaffirm a debt secured by a consensual security interest . . . or submitting to the creditor's repossession of the collateral. . . . In many instances the collateral is essential in the debtor's household or to his employment. Its value to him may be much greater than *the price it obtains at a repossession or foreclosure sale.* Thus, to the extent that the amount of the debt exceeds *the value of the collateral*, the debtor reaffirming a debt loses the benefit of the discharge and of the "fresh start" which it is intended to provide.

Commission Report, Part II, at 131.

While the Commission proposed allowing reaffirmation of secured debt, it proposed limiting such to the "fair market value" of the security. As a method for making this determination, the Commission stated as the most appropriate standard *"the net amount the creditor would receive were he to repossess the collateral and dispose of it as permitted by the applicable bankruptcy law."* Commission Report, Part II, at 131.

After Congress received the Commission's Report, the National Conference of Bankruptcy Judges proposed an alternative bill. While it differed substantially from the Commission's proposal, it also recognized problems arising from forced reaffirmation of secured debt. Like the Commission Report, in doing so it recognized that, consistent with bankruptcy rule, repossession and resale provide the baseline for valuing secured collateral.

> The mere threat of repossession operates as pressure on the debtor to pay the secured creditor more than *he would receive were he actually to repossess and sell the goods.* Current Chapter XIII does little to recognize the differences between

> the *true value of the goods* and their value as leverage. Proposed 13 instead views the secured creditor relationship as a financial relationship, not one where extraneous, non-financial pressures should enter.

Report of the Committee on the Judiciary, House of Representatives, To Accompany H.R. 8200, H.R. Rep. No. 95-595, 95th Cong., 1st Sess. (1977).

The Bankruptcy Code's legislative history nowhere hints of an intent to break with the bankruptcy rule's tradition of valuing secured collateral by reference to proceeds that would result from repossession and resale. Indeed, that history points to a contrary conclusion. Events occurring after Congress enacted section 506(a) confirm that Congress intended continued homage to the bankruptcy rule.

C. After Enacting 11 U.S.C. § 506, Congress Demonstrated That It Did Not Intend That Statute To Deviate From Practice Under The Bankruptcy Rule

Given the language and history of section 506(a), courts interpreted it consistent with the bankruptcy rule's requirement that value of secured collateral was set at an amount that would be obtained from a commercially reasonable disposition of the collateral. *See, e.g., In re Darmron*, 8 B.R. 323, 326 (S.D. Ohio 1980); *In re Savloff*, 4 B.R. 285, 287 (E.D. Pa. 1980). As in this case, credit industry representatives sought to change this result, and in December 1981, S. 2000 was introduced to do so. The Committee Report describes the reason for the proposed change.

> The existing provisions of the Bankruptcy Code stipulate that the value of the property of a debtor's estate must be determined on the basis of the proposed disposition or use of that property. . . . *Many courts have fixated upon wholesale resale (as) the appropriate standard, even for property with a high resale value in the retail market. . . . [T]he proposed bill specifies the preference of the Code for use of a resale market standard. . . .*

Report of the Judiciary Committee to the Senate, Senate Rep. No. 97-446, 97th Cong., 2d Sess. (1981).

In 1983, S. 445 was introduced which contained many of S. 2000's provisions, including an identical proposed change to section 506(a), as well as changes to sections 506(b) and (d). Although Congress did not enact S. 445, Congress did enact that bill's proposed changes to sections 506(b) and (d). Congress did not, however, enact the proposed change to section 506(a). Thus, Congress rejected credit industry overtures to have section 506(a) break from the bankruptcy rule's tradition of valuing secured collateral from the perspective of how much money a creditor could obtain if he repossessed the collateral and sold it.

CONCLUSION

No evidence suggests that Congress intended section 506(a) to depart from the bankruptcy rule. Indeed, section 506(a)'s express language, its legislative history, and events occurring after its enactment, all point to a contrary conclusion. This Court should therefore affirm the decision of the *en banc* Fifth Circuit and reject Associate's attempt to obtain a result inconsistent with the bankruptcy rule's centuries-old tradition.

Respectfully submitted,

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